MASSACHUSETTS INCOME TAX

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Massachusetts Income Tax

by

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Topical Outline of Thesis

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Chapter 1 Introduction

Ever since the commencement of taxation,taxes have played a dynamic and influential role in the lives of every taxpayer.At the very beginning it is true that this influence was not felt to the same extent that it is at the present time.

It is the purpose of this thesis to make a detailed examination of the income tax law,which was passed by the state legislature in 1916,as well as the events leading up to the passage of this act.In order to study the development of the act since it was passed it will be necessary to examine the reports which are made annually by the Commissioner of Taxation.

In chapter 2 the historical background of the tax will be examined.It seems pertinent to the understanding of the thesis that this data should be made clear at the outset. If this historical background were limited to the Commonwealth of Massachusetts the whole picture would not be given and the description as a whole would suffer from incompletness.Therefore it is deemed advisable to depict some of the events which have taken place in other countries as well.

In chapter 3 an endeavor will be made to explain the intention and purpose of the Massachusetts income tax.The primary purpose of all taxes is to raise revenue through compulsory contributions to be used for public purposes. While it is quite true that this end has been accomplished by the Massachusetts

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income tax,the intention in originating the tax was somewhat different as will be clarified by the description of the tax in this chapter.

In chapter 4 it seems appropiate to present the evolution of the income tax.As will be seen later the situation was the same here in Massachusetts as in other states and countries, which encountered similar experiences in arriving at the levying of the income tax to supplement or take the place of the other taxes.

In chapter 5 the preliminary procedure to change the Massachusetts constitution is explained.

In chapter 6 the diverse parts of the Massachusetts income tax law are explained:Types of income taxed,exemptions, returns,assessments,administration,collections,abatements,and penalties.

In chapter 7 the various changes which have been made in the law are explained.

In chapter 8 the important court decisions are set forth.

In chapter 9 the reports of the Commissioner of Taxation are examined to show how the act developed and was administered after it was passed.

In chapter 10 a comparison of the problem of income taxation in Massachusetts is made with those of the other states.

In chapter 11 the conclusions are set forth.

Chapter 2 Historical Background

The history of the Massachusetts income tax dates back to the early laws of the Massachusetts Bay Colony.The National Industrial Conference Board has found that Massachusetts is the only state that has had some kind of partial income tax in effect continously since the early colonial period.[1]

In order to arrive at a composite picture of the history of the income tax it will be necessary to examine the tax as it has existed in some of the other countries.

Some authors have found that the income tax antecedes the Christian era and there might have been one in Egypt as early as 5000 B.C. .

During the middle ages taxes did not play the gigantic role in the lives of the people that they do at the present time. At that time most revenue was derived from feudal payments which were exacted by the feudal lord.These feudal payments were made to a large extent in kind. With a rise of a money economy taxes began to play an overwhelming part in the revenue of the various rulers of the time.

According to E.R. Seligman[2] "The only important country in which we find the income tax developed for state purposes

1 National Industrial Conference Board,The Fiscal Problem In Massachusetts,(New York:National Industrial Conference Board,1951,554 pp)

2 Edwin R.A. Seligman,The Income Tax ,(New York:The Macmillan Company 1921,745 pp. p 49)

before the nineteenth century is France." The 'taille' was the most important French tax during the middle ages. This was originally a domain tax but became a national tax in 1439 , although it was intended to include personalty,it became practically an apportioned tax on agricultural land.In 1710 a tax known as dixieme or tenth was introduced.This was supposed to be a tax of ten per cent on all incomes throughout the country

E.R.Seligman[1] says,

> "The dixieme was supposed to be a general income tax reaching income of four kinds; namely from real estate,from salaries, from securities,and from business.But the tax soon showed the same weaknesses as its predecessors.One by one various individuals and classes secured exemptions from the tax.Especially the vingtieme d'industrie,the income tax on business, soon became a farce.The historians tell us of the ludicrous yield(le rendement dérisoire)of the tax,and before long not only did the Tenth and Twentieth become quite as arbitrary as the capitation,but what was originally a percentage tax became an apportioned tax..... a development entirely analogous to that of the land tax in England."

England has had an income tax since 1798.This was largely an outgrowth of the industrial revolution and the wars with France.The income tax in England has existed in its present form for about 100 years.

Prussia supplemented the classified poll tax in 1851 by an income tax on the larger incomes throughout the kingdom,by 1891 the classified poll tax had given way entirely to a progressive income tax.

1 ibid ,p 52

In the United States the income tax was imposed in 1862 and again in 1894,but the present tax did not become effective until 1913.

In 1634 the Massachusetts Bay Colony passed one of the first tax laws in the American colonies.This provided for the assessment of each man "according to his estate and with consideration of all other abilityes whatsoever."[1]

In 1643 the New Plymouth Colony appointed assessors to rate all individuals in that colony,"according to their estates or faculties,that is,according to goods,lands improoued faculties and sonall abillities."[2] E.R.Seligman says,[3]

> "The court order of 1643 provides not only for the assessment of personal and real estate,but distinctly mentions 'laborers,artificers,and handicraftsmen' as subject to taxation."

Here it is evident that it was intended to tax personal income as well as property.

1 ibid, p 368
2 ibid, p 368
3 ibid, p 368

Chapter 3 Intention of the Tax

In order to more thoroughly understand the Massachusetts income tax law it is necessary at first to make a preliminary investigation of the intention that the individuals favored the adoption of this law and those who framed it had in mind.The law did not have its origin solely for the purpose of raising revenue or increasing the then existent revenue.There existed at that time many evils as a result of the prevalent law governing the tax on general property.Philip Nichols writing about this period says,[1]

> "The real object of the statute was not so much to produce additional revenue for public use,as to provide a more satisfactory system for the taxation of intangible personal property than that which had been in use since intangible personal property had come into existence."

During the colonial period,and for some time after, it was the usual practice to tax all personal property at its 'situs' and also it was customary for the owner of all personal property to pay this tax on personal property on the value placed upon it by the assessors at the same rate as if it had been a piece of real estate.For instance,if the rate on real estate in the particular town in which the individual resided had been by chance set at $5 per thousand and this person had been assessed for $2000 worth of intangible property then he would have to pay a tax of $10.It is not very difficult to tax

[1] Philip Nichols,Taxation In Massachusetts,(Boston:Finiancial Publishing Company,1938,Third Edition,353 pp , p 173)

a house or a factory or business when they are all located in in the same town.For it would be impossible to hide a house or a factory from the assessors during the time that they were assessing personal property.Nevertheless,it is an entirely different matter when the assessors are confronted with task of ascertaining the value of intangible personal property.Under these circumstances it is comparatively easy to conceal the exact amount of intangible property that one has in his possession For in contrast to a house or a factory this intangible personal property is not visible to the assessors.

Another factor involved in this consideration is that the rate levied on this intangible personal property,as well as all other property,varies from town to town.Since this property is taxed at the residence of the owner it developed that it would become extremely profitable for an individual who possessed an excessive amount of intangible personal property to take up his residence in a place where the tax rate was exceedingly small and where the assessors possessed a reputation of great leniency in regard to putting the temporary residents down for merely a trifling amount,which would result in a meagre fractional proportion of the regular amount that they would have received in their real place of residence.It is not at all surprising that this situation evolved under these circumstances.

In the larger cities the tax rate was usually very high,while in the smaller towns the tax rate was usually very

low.It was a common practice for individuals,who had large incomes,to own a summer dwelling in these smaller towns. Consequently,it was an easy matter for them to participate in a great exodus to these smaller places the day before the tax was due in order to establish residence there,and return to the city the following night.On account of these evasions of the law,for they could not possibly be termed violations,an extremely large amount of revenue was lost to the cities where these individuals resided for the greater part of the year.

This situation is very prevalent when a tax differs from town to town and it is possible to either transfer the object which is taxed or the residence of the individual who has to pay the tax.When each town or city levies their own tax rate individually,each place usually has a different tax rate.If the state has the preogative of collecting the tax for the various towns and cities,the rate is uniform throughout the whole commonwealth.This is exactly the circumstance under the present income tax law for Massachusetts.This was one of the evils which the present law was intended to circumvent .

Philip Nichols says,[1]

> "The evil was aggravated by the inevitable effect of such asserted changes in domicile in making tax rates of the towns in which domicile was claimed grow lower and lower as the aggregate of taxable prop-

[1] ibid, p464-465

> erty was thus illegitimately increased, while the tax rate of the cities deserted for purposes of assessment only by their wealthiest inhabitants was correspondingly increased. Furthermore, when a small town might acquire an increase of its taxable property by the mere assertion of a wealthy summer resident's intent to make it his legal residence, the temptation to an express or implied understanding that if the taxpayer would make the town his domicile the assessors would deal leniently with him was almost irresistible; and, if there was no such understanding, the assessors of small country towns were seldom men of sufficient business enterprise to be able to make any estimate of the probable wealth of the newcomer, or lacked the time or means to make an extensive examination of the subject. Even if they had the inclination, the time and the means, there was no means by which they could unearth the holdings of one of their summer residents in the stocks and bonds of the innumerable corporations of other states and other countries. As a consequence of these various influences, men generally recognized as millioaires escaped with a nominal personal property tax and hardly a fifth of the personal property in this commonwealth was subject to taxation; and much of that was assessed in towns whose tax rates were lowest."

The state is in a much better position to collect the tax on intangible personal property for the various towns and cities for not only is the tax rate uniform throughout the commonwealth, but the state has many more opportunities of discovering the exact amount of intangible personal property than the various towns and cities. Their facilities are larger to a great extent, and in many instances the methods that they employ are much more refined in accomplishing this undertaking. At the present time all Massachusetts corporations as well as

foreign corporations who do business in Massachusetts are obliged to make reports to the commonwealth in regard to the ownership of stocks and bonds in their respective corporations. Thus,it is comparatively simple for a clerk to check these reports and perhaps discover that some individual has inadvertently neglected to include the revenue from certain stocks and bonds in his return.While it is quite true that this does not exclude all possibilities of evasion as many foreign corporations do not necessarily do business in the Commonwealth of Massachusetts,and thus it can not be all inclusive,nevertheless, it serves as a very excellent preventive check.

It was to remedy such evil practices that the income tax law was passed in 1916.There were early reforms,which preceded the passage of this act and they will be treated in the following chapter.

Chapter 4 Evolution of the Tax

By income in this chapter is meant personal income only. The income, which is derived from corporations is beyond the scope of this thesis.

Professor H.L. Lutz defines income as [1],

> "a gain derived from capital, from labor, or from both combined, provided that it be understood to include profit gained through the sale or conversion of capital assets."

In the Commonwealth of Massachusetts under the present income tax law only certain types of income are taxable. The types of income which are taxable are treated in detail in chapter 6 of this thesis.

The early tax on intangible personal property was described in chapter two of this thesis. It is the purpose of this chapter to describe the early reforms which were made in regard to this tax. Also it is intended to include some of the suggestions by proponents of various changes which would have made very great changes in the tax laws if they had been adopted. This will bring the controversial aspects of the case up to the passage of the forty-fourth amendment to the constitution of the Commonwealth of Massachusetts, which had to precede the the passage of the income tax law of 1916. The passage of this amendment to the constitution will be described in the following chapter.

[1] Harley Leist Lutz, Public Finance, (New York: D. Appleton-Century Company, Inc. 1947, Fourth Edition, 718 pp p5?9)

In 1865 a law was passed, which made it mandatory for the savings banks to pay a tax on their deposits. This method introduced the system known popularly as stoppage at the source. Under this system the banks pay a tax on all of their deposits for their depositors. After the passage of this act it was no longer necessary to include the savings in Massachusetts Saving Banks when they listed the personal property annually. Since the passage of the 1915 income tax law this tax has continued, but the individual does not have to include this source of revenue in his state income tax return, although that is not the case when the individual is calculating his return for purposes of federal income taxes, for then it is necessary that this source of revenue be included in the total for the year.

In 1864 a similar law was enacted, which introduced a tax on the capital stock in Massachusetts corporations. The stoppage at the source was also the method which was used to collect the tax under this law. The same procedure was followed after the passage of the income tax law of 1916 as was employed with the tax on the savings in Massachusetts Savings Banks. The tax on the capital stock of foreign corporations which includes all corporations outside the Commonwealth of Massachusetts remained the same as existed previously.

In 1881 a special law was passed governing the tax on mortgages on taxable Massachusetts realty. Prior to the passage of this act both the mortgagee and the mortgagor had to pay the tax on the mortgage. In actual practice the result was that

the mortgagor was usually capable of escaping this tax. For, here again, it was difficult to ascertain who actually held the mortgages.After the passage of this act only the mortgagee or the mortgagor was required to pay the tax.It was usually agreed that the mortgagor would pay the tax,although there were exceptions to this general rule.In the case where the mortgage or the mortgages exceeded the assessed valuation of the property it was necessary for the holder of the last mortgage to pay a tax on this excess amount.

Personal earnings over $2,000 (faculty-income) and stocks bonds and notes were taxed under the general property tax prior to 1916 when the income tax law was enacted by the legislature.

The Physiocrats believed that the extractive industries were the only ones which produced a surplus,and proposed a single tax on the net income from land.

Henry George,"Progress and Poverty",1879 proposed that the government should appropiate economic rent relieving labor and thrift from taxation.

It is generally agreed among writers on the subject that diversity in taxation is more satisfactory than a single tax,nevertheless,single taxes have been proposed,as the preceding examples illustrate.In Massachusetts,although no single tax has been proposed that I know,in regard to the income tax it has been felt prior to the passage of the 1916 income tax law that the tax should be made more effective or abolished

from the statutes. In 1875 a special tax commission was appointed to investigate the system of taxation in Massachusetts. Seligman[1] says the reported,

> "no one of our taxes reveals so great a lack of uniformity in its construction and enforcement, and such a wide difference in opinion as to its worth, as is found with reference to the income tax."

In many communities the faculty tax on incomes was entirely ignored, while in others very little attention was paid to it. Seligman[2] says one man, "objected strongly to what he considered the undue exemption of two thousand dollars."

1 Seligman, op. cit. p 391

2 ibid, p 392

Chapter 5 The 44th Amendment

In November of 1915 the people approved and ratified the 44th amendment to the constitution of this commonwealth, which is stated as follows:

> 'Full power and authority are hereby given and granted to the general court to impose and levy a tax on incomes in the manner hereinafter provided. Such tax may be at different rates upon income derived from different classes of property, but shall be levied at a uniform rate throughout the commonwealth upon income derived from the same class of property. The general court may tax income not received from property at a lower rate than income derived from property, and may grant reasonable exemptions and abatements. Any class of property the income from which is taxed under the provisions of this article may be exempted from the imposition and levying of proportional and reasonable assessments, rates and taxes as at present authorized by the constitution."

Before an income tax law could be passed it was necessary to make this amendment to the constitution of the commonwealth. On May 18, 1915 the state legislature adopted an amendment to the State Constitution, striking out the word proportional in relation to taxation.

Philip Nichols says,[1]

> "The real purpose of the forty-fourth amendment was to authorize the taxation of the classes of income which are taxed by the present law, the amendment itself is not so

[1] Nichols, op. cit. p155

> limited,but authorizes the taxation of income of every class and description which the legislature may at any time see fit to tax."

The terms of the amendment do,however,place restrictions on the taxation of incomes.Philip Nichols treats of these limitations,[1] when he says,

> "In the first place,there is the limitation imposed by the amendment itself that the tax shall be levied at a uniform rate throughout the commonwealth upon incomes derived from the same class of property,which prohibits a graded income tax as is imposed by the federal law,and also prohibits income taxes in force in certain cities and towns only,or imposed at different rates in different cities and towns."

[1] ibid , pp 468-469

Chapter 3 Operation of the Law

After the Forty-Fourth Amendment to the constitution of the Commonwealth of Massachusetts had been ratified and approved by the people of Massachusetts in 1915, the state legislature facilitated the enactment of an income tax law expeditiously the following year.

It is the primary purpose of this chapter to describe in detail the various parts of this law enacted by the legislature. It is quite evident that in a law, which, is of such a nature as this one, some sections will be more important than others and some sections will require more detailed descriptions than others, so therefore all sections will not be given equal length in the treatment of that particular section. Also it might be said that some sections cover a great many more details than do others.

The Massachusetts income tax is usually referred to as a partial or classified income tax. The reason that this custom is prevalent is due to the fact that only certain types of income or the income from particular specified sources are able to be taxed under the terms which are provided by the various parts of the law.

This is in marked contrast to the practice which is followed by the department of internal revenue in levying the federal income tax. In general, it might be well stated that under the federal income tax law taxes are collected on the incomes which are received by the various individuals and only

then permits certain deductions for specified reasons and under very exact and precise circumstances.

Section one provides that a tax upon incomes be levied in 1917 and in each of the following years afterwards as set forth in the other parts of the act.

A) The Types of Income Taxed

Section two provides for the taxation of incomes which are derived from certain intangibles. A tax of six per cent per annum was levied on the income from bonds, notes, money at interest and all debts due the person to be taxed . The Massachusetts Statutes states,[1]

> "Sec. 2 Income of the following classes received by any inhabitant of this commonwealth during the calendar year prior to the assessment of the tax shall be taxed at the rate of six per cent per annum:
>
> (a) Interest from bonds, notes, money at interest and all debts due the person to be taxed, except from:
>
> First: Deposits in any savings bank chartered by this commonwealth or in the Massachusetts Hospital Life Insurance Company, or such of the deposits in the savings department of any trust company so chartered as do not exceed in amount the limits imposed upon deposits in savings banks by section forty-six of chapter five hundred and ninety of the acts of the year nineteen hundred and eight, and the acts in amendment thereof and in addition thereto.
>
> Second: Bonds of the United States and such bonds notes and certificates

[1] Frank A. Worth, The Income Tax, (Boston: Johnson and Worth 1917 159 pp pp 107-108

> of indebtedness of the commonwealth and of political subdivisions thereof as are exempt from taxation under the provisions of clause fifteen of section five of Part 1 of chapter four hundred and ninety of the acts of the year nineteen hundred and nine and the act in amendment thereof and in addition thereto.
>
> Third:Loans secured entirely by mortgages of real estate,taxable as real estate,situated within the commonwealth,to an amount not exceeding the assessed value of the mortgaged real estate."

In the case of the first exception the reason that it was not made subject to the tax resulted from the special law which had already taxed this type of income under the law of 1862.

The reason for the second exception was quite different.The supreme court interpreted the constitution to mean that neither the federal government nor any of the several states shall tax the instrumentalities of the other one. The above is based on the decision which was rendered by Chief Justice John Marshall in "McCulloch v. Maryland"(1819) and "Osborn v. United States Bank" (1824) in which the Chief Justice maintained that taxes of such a nature were unconstitutional on the ground that no state might destroy any agency of the federal government which the Constitution allowed it to establish.

The reason for the third exception is quite similar to the first exception in that this type of income had already been taxed under a special law in 1911.These two laws of

1862 and 1881 have already been described in detail in chapter 4 so they are only mentioned here in passing.

There is also a tax of six per cent per annum on the shares of all corporations organized outside of the Commonwealth of Massachusetts. The Massachusetts statutes reads as follows:[1]

> Sec.2 (b) "Dividends on shares in all corporations and joint-stock companies organized under the laws of any state or nation other than this commonwealth except such foreign corporations as are subject to a tax upon their franchises payable to this commonwealth under the provisions of forty-three and fifty-two of Part IIIof chapter four hundred and ninety of the acts of the year nineteen hundred and nine, and the acts in amendment thereof and in addition thereto."

The reason the income from dividends and shares of Massachusetts corporations were not included in this category is that this income was already taxed under a special law of 1864.

The dividends on shares in partnerships and the like are also taxed at the rate of six per cent per annum. The Massachusetts statutes concerning this tax and certain exceptions reads as follows:[2]

> Sec.2 (c) Dividends on shares in partnerships, associations or trusts, the beneficial interests in which is represented by transferable shares, except dividends on shares of the following:
> First: Partnerships, associations or trusts, which file with the tax commissioner the agreement hereinafter

1 Ibid, p108
2 Ibid, p108-109

provided for, and the property of which consists exclusively of one or more of the following kinds of property, to wit: real estate wherever situated and supplies therefor and receipts therefrom; stocks of corporations taxable under the provisions of forty-three and fifty-two of part III of chapter four hundred and ninety of the acts of the year nineteen hundred and nine and the acts in amendment thereof and in addition thereto.

Second: Partnerships, associations or trusts the beneficial interest in which is represented by transferable shares, which file such agreement and furnish satisfactory proof to the tax commissioner that two-thirds at least, of their taxable property is taxed within the the commonwealth, and that the remainder, if taxable, is taxed where it is situated."

Income from an annuity shall be taxed at the rate of one half per cent per annum.

The excess of gains over losses received by the taxpayer from purchases or sales of intangible personal property, whether or not the taxpayer in question is engaged in the business of dealing in such property shall be taxed at the rate of three per cent per annum.

The excess over two thousand dollars of the income derived from professions, employments, trade or business shall be taxed at the rate of one and one half per cent per annum. However, the following deductions are permitted: (1) $500 for the taxpayer's wife or husband; (2) $250 for each child under eighteen years of age and incapable of self support because of mental or physical deficiencies; (3) $250 for either or both parent entirely dependent upon the taxpayer for support.

B) Exemptions:

The following exemptions are permitted:Debts, except those which are secured by mortgage or pledge of real estate or tangible personal property;all debts owed by other persons.A person who has an income from all sources which does not exceed six hundred dollars during the year in which the tax is assessed shall have an exemption of three hundred dollars of that part of his income which is liable to taxation under section two of this act.

C) Returns

In regard to the making of returns,every individual inhabitant of the commonwealth,including every partnership,association or trust,whose annual income from all sources exceeds two thousands of dollars must make out a return of his entire income annually.There are exceptions in which the income is not included in figuring the two thousand dollars.The most important of these exceptions are: the income derived from real estate,from the dividends exempt from from taxation under section two of this income tax act of 1913, from interest upon bonds or other obligations of the United States,from interest upon bonds,notes and certificates of indebtedness of the commonwealth and political subdivisions thereof as are exempt from taxation and a few certain other classes of income.

D) Assessment and Administration

The tax commissioner is obliged to determine the

income of every individual who is to be taxed under this act and assess the amount of the tax provided by this income tax act of 1916.The tax commissioner has the privilege of making certain rules and regulations on the condition that they are not inconsistent with the provisions of the act.

E) Collections

The Commissioner is obliged to give written notice to every person assessed of the amount of the tax assessed as well as the time the tax or any unpaid balance is required to be paid. All taxes received by the income tax assessors has to be accounted for and turned over to the tax commissioner at least once each week,but it can be turned over more often.

F) Abatement

Any person who is aggrieved by the assessment of a tax under the provisions of this act may apply to the tax commissioner for an abatement at any time within thirty days after the date of the notice of the assessment.The tax commissioner then holds a hearing and if he is satisfied that the tax is excessive in amount,or that the person assessed is not subject to the tax,has the privilege of abating the tax either in whole or in part.

G)Penalties

If a person is required to file a return under the provisions of this act and should fail to file the return within the prescribed time by the conditions of the act,the

sum of five dollars for every day in which the person is in default, is added to and becomes part of the tax, as an additional tax. However, the tax commissioner may, if he so discreted, abate any such additional tax either in whole or in part.

If a person files a fraudelent return he may under certain conditions be subject to a tax or a fine, of not less than one hundred dollars or more than ten thousand dollars or by imprisonment for not more than one year or by imprisonment for not more than one year or by both such fine and imprisonment.

Chapter 7 Changes In The Law

This chapter deals with the important changes which have been made in the income tax law, which was originally passed in 1916.

A) On May 29, 1922 the limitation of $1,000 was eliminated. The reason for this was that a person with more than one child was being penalized because of this limitation, and it was thought by some that a great impetus would be given to birth control due to this fact.

B) An amendment of 1932 provided that interest on unpaid taxes should accrue from the due date and required resident fiduciaries to make returns on taxable income distributed to inhabitants of Massachusetts[1][2].

C) An amendment of 1933[3] changed the provisions relating to verification of returns, assessments, and abatement made in two equal parts, one half with the return and the other half on Oct. 1 following.

D) An amendment of 1934[4] extended the tax on gains over losses from purchases or sales of intangible personal property to shares of stocks in partnerships, associations or trusts.

E) An amendment of 1935[5] imposed a tax of 50 %

1 Chapter 152, Acts of 1932
2 Chapter 182, Acts of 1932
3 Chapter 350, Acts of 1933
4 Chapter 3[illegible], Acts of 1934
5 Chapter 458, Acts of 1935

upon gains realized from the taking of property by eminent domain within a year after the property had been acquired by the taxpayer,[1] also deleted the provision allowing the deduction from gross income of 5% of the assessed value of tangible property employed without the Commonwealth,[2] also included Federal salaries in gross income and exempted from tax the dividends on shares of any partnerships,association or trust in operation of real estate upon payment of such business of a tax of income from their property.

F)An amendment in 1937[3] required the application for abatement of taxes to be made in writing on forms approved by the commissioner.

G)An amendment of 1939[4] changed the board of tax appeals to the Appelate Tax Board,also exempted federal salaries under certain conditions.[5]

H)An amendment in 1941[6] imposed a surtax applicable to the year 1942 and there after.

I)An amendment of 1943[7] required returns to be filed with the Commissioner rather than with the Commissioner

1 Chapter 456,Acts of 1935
2 Chapter 489,Acts of 1935
3 Chapter 135,Acts of 1937
4 Chapter 451,Acts of 1939
5 Chapter 729,Acts of 1941
6 Chapter 45,Acts of 1943
7 Chapter 511,Acts of 1943

or the tax assessor at the taxpayer's option,[1] also allowed a $250 deduction in respect of each child over 16 entirely dependent on the taxpayer for support because of physical or mental disability.

J)An amendment of 1945[2] provided for the abatement by the Appelate Tax Board of uncollectable taxes at any time after two years following the date they became due,[3] also it exempted from taxation unemployment compensation benefits both Commonwealth and Federal,[4] Also it provided for the taxation of dividends on shares in all corporations,joint stock companies,and banking associations excepting certain institutions.

K)An amendment of 1946[5] exempted from taxation interest on shares and savings accounts in cooperative banks, also it exempted from taxation the service pay of non-commissioned personnel who served in World War II and extended the time of filing returns and making payment by members of the the armed forces.[6]

1 Chapter 511,Acts of 1945
2 Chapter 525,Acts of 1945
3 Chapter 625,Acts of 1945
4 Chapter 735,Acts of 1945
5 Chapter 539,Acts of 1946
6 Chapter 604,Acts of 1946

L)An amendment of 1947[1] allowed employers a deduction from taxable income for payments made to a pension fund. Exemption from tax was granted to employees with respect to such payments made by employers,and the income from the pension fund was also exempted from taxation.

1
Chapter 459,Acts of 1946

Chapter 9 Important Court Decisions

The purpose of this chapter is to set forth a presentation of the most important court decisions which have been rendered and handed down in connection with the Massachusetts Income Tax Law. Due to the large number of these cases it will be necessary to avoid minute details and confine the description to a general nature. These decisions have been selected with the view of presenting how the courts have construed the meaning of the act since it was passed by the legislature in 1916.

The manner in which the courts interprets the meaning of any law has a great bearing on the effectiveness of that law under consideration.

(1) Trefy v. Garfield[1]

This decision upheld the taxation of "rights", stock dividends and dividends earned prior to 1916.

(2) Faulkner v. Trefy[2]

In this decision which was made Jan. 5, 1918 it was held the act did not apply to income received during the portion of the year prior to death by a person who deceased in November.

(3) Goldman v. Trefy[3]

This case, known as the "Pawnbroker case", decides that the interest received by a pawnbroker in the course of his

1 227 Mass. 522

2 229 Mass. 120

3 230 Mass. 201

business may be taxed at the rate of six per cent even though it is income received from a profession, employment, trade or business. In subsequent legislation the tax was changed so that it was to be levied at the rate of one and a half per cent.

(4) Maguire v. Tax Commissioner[1]

This case decides that the income from intangible personal property held under a testamentary trust in another state by a trustee there taxed, therefore, is exempt from taxation under the Massachusetts Income Tax Law to the beneficiary resident in Massachusetts, but such beneficiary is taxable in respect of income actually received by him from such trust in another state, and not taxed there, if such income is of the kind that would be taxable under the Massachusetts Income Tax Law. It is also decided in this case that the tax imposed by the Massachusetts Income Tax Law upon income received by a resident of Massachusetts from intangible personal property held for his benefit by a trustee resident in another state, and not taxed in such other state, is valid and does not violate the Fourteenth amendment to the Constitution of the United States.

[1] 260 Mass. 503

(5) Briscoe and Blackman v. Tax Commissioner[1]

In this case it was decided that employees of railroad companies were exempt from taxation on salaries as government employees as long as the railroad companies were under government control. The decision went on to state that Federal salaries could not be considered in determining the amount of the $2000 exemption, as originally provided in the statute.

(6) Wheelright v. Tax Commissioner[2]

In this case the court decided that executors were not permitted as under provisions for trustees to make deductions on account of certain expenses.

(7) Hart v. Tax Commissioner[3]

This was a very important case which decided that the income tax was a property tax and not an excise tax and part of the statute requiring a tax on incomes received during the last calendar year, where the recipient becomes domiciled in Massachusetts after January 1 and on or before June 30 following the year of receipt of the income is unconstitutional.

(8) Brown v. Henry F. Long[4]

In this case it was decided that the gain from the sale of intangible personal property under section 5 (c) of the law should be calculated in such a manner so that the gain should not be more than the excess of sale price over cost.

1 256 Mass. 201 2 240 Mass. 564 3 241 Mass. 37 4 242 Mass. 242

Even where purchased or otherwise acquired prior to January 1, 1916 and the value of that date is less than the cost. This decision necessitated a revision of the rules in force since the beginning of the operation of the law relative to the computation of gains and losses, and made the practice of Massachusetts conform to the Federal practice in this respect.

(9) Moulton v. Henry F. Long, Commissioner[1]

In this case the court held that no tax could be assessed on a profit from the transferral of a lease containing an option for purchase.

(10) Loevy v. Commissioner[2]

This case holds that the "taxable year" is not divisible, and if a person becomes a resident in Massachusetts at any time prior to January 1, he must report in his return which must be filed between January 1 and March 1 in the year following his income for the whole of the prior calendar year.

(11) Bingham v. Commissioner[3]

This is the case in which the principle was established that in computing the gains or losses from purchases or sales of intangible personal property by executors the cost is to be taken as the actual value of such property on the date of the death of the testator.

(12) Kennedy v. Commissioner[4]

[1] 243 Mass. 129
[2] 245 Mass. 174
[3] 249 Mass. 79
[4] 256 Mass. 426

This case overruled the Loevy case and held that the "tax year" was divisible and since the tax is a property tax a person becoming a citizen during the taxable year can only be taxed for income received after becoming an inhabitant.

(13) Van Heusen v. Commissioner[1]

This case deals with the sale of assets to a corporation wherein the shares of stock of the new corporation are accepted in payment for the assets of the old corporation, constituted a sale, but since the stock of the new corporation was not dealt in on the market no ascertainable profit from such sale could be found to have been received until a sale of the stock took place.

(14) Rockwood v. Commissioner[2]

Here the court held that taxation of income in the form of royalties for the use of patents issued by the Federal Government, constitutes a tax on the royalties, in violation of the principles of the Federal Constitution, and accordingly that such royalties are not taxable. This decision was overruled in 1932 by the United States Supreme Court in the "Fox Film" Case.

(15) Parker v. Commissioner[3]

This decision held that the only profit taxable at the time of sale is the difference between the value on the date of

1 257 Mass. 522
2 257 Mass. 572
3 258 Mass. 379

receipt and the amount received at the time of sale. This results in the complete exemption from any tax on the value of the stock when received as a dividend and later sold.

(16) Hayes v. Commissioner[1]

This case involves the classification of income received for the issuance of credit orders for the purchase of clothing. The court held that it was not interest but rather an addition to the sale of the goods.

(17) Boston Safe Deposit and Trust Company v. Commissioner[2]

In this case the court upheld the taxation of dividends received in liquidation in excess of par value of the stock.

(18) Whipple v. Tax Commissioner[3]

In this case the Supreme Court ruled that the lower court justice erred in including in the definition of "business" an occupation in which a person is engaged with the hope or expectation of conferring a benefit upon himself or others saying that this definition goes beyond the meaning of the statute, and affirms as an essentially correct statement of the law that "business" is a word of large signification and denotes that which occupies the time, attention and labor of men for the purpose of a livelihood or profit, although it need not be the sole occupation or employment.

(19) Bacon v. Commissioner of Corporations and Taxation[4]

[1] 261 Mass. 522
[2] 262 Mass. 1
[3] 263 Mass. 476
[4] 266 Mass. 547

This case concerns the judicial interpretation of the meaning of an "annuity". Mr. Bacon sold his business and was to receive $52,000 per year as long as he lived. The court held that these payments made to Mr. Bacon satisfy every element of an annuity as generally understood and further observes that if the complainant had sold his interest in the firm for cash and paid the entire sum thus received to an insurance company for the purchase of an annuity there could be no doubt that the payment made to him each year as a result of such a transaction would be an annuity, and that this would differ in no essential from the rights of the complainant under his contract with his partners.

(20) Williams vs. Commissioner of Corporations and Taxation[1]

In this case the court held that the trust was engaged in a single business of which the sale and rental of real estate was but different phases,---and goes on to say that if rents received by the trust are not taxable as business income and are not to be included in gross income---the trust may deduct all from the profit realized from a sale of part of its property, all of its expenses in connection with the renting of the property as well as 5% of the assessed value of all the property owned by the trust and used in its business.

(21) Allen vs. Commissioner of Corporations and Taxation[2]

1 272 Mass. 249

2 272 Mass. 502

Here the court held that the sale of rights are acquired otherwise than by purchase and accordingly the cost must be taken at the value thereof on the date when it was acquired.

(22) Hutchins vs. Commissioner of Corporation and Taxation[1]

In this case the court found that since the testator died a resident of New York, and that the laws of that state establish a situs for taxation in New York, and that there is no room for a situs of the same property for taxation within this Commonwealth.

(23) Dodge vs. Commissioner of Corporations and Taxation[2]

This case involved the taxability as a dividend of the one half share of Pullman Incorporated paid to shareholders of Pullman Company as part of reorganization plan. The court held that in essence and in truth it was a dividend.

(24) First National Bank of Boston v. Commissioner of Corporations and Taxations[3]

This was an appeal from an assessment of a tax of 3% upon gains realized from the sale of intangible personal property by a trustee. The court held that while he had not revoked the trust, he had the power to do so and that sales made by the trustees were sales made by him and that the gain was to be computed from the cost to the donor and not from the value of

1 272 Mass. 422

2 273 Mass. 187

3 274 Mass. 583

the securities, on the day the securities were turned over to the trustees, as maintained by the commissioner.

(25) DeBlois vs. Commissioner of Corporations and Taxation[1]

In this case the court held that a tax upon the income of real estate was a tax upon the real estate itself and as real estate was then bearing a heavy local tax upon its fair cash value, an income tax upon the net rentals was double taxation. The court said that it had been the policy of the General Court to scrupulously avoid double taxation on real estate in forming statutes, and that words of unmistakable purport would be needed to express a legislative purpose to impose such double taxation. They held that section 22 clearly intended to exempt rents received from real estate.

(26) The First National Bank of Boston vs. Commissioner of Corporations and Taxation[2]

In this case the testatrix died a resident of Vermont, and claimed that the property involved had a situs there in Vermont, being subject to the property tax there, and that Massachusetts had no authority to tax. The Commissioner contended that the tax was on the beneficiary who was a resident of Massachusetts and the tax properly assessed under General Law Chapter 62 section 10. The court decided in favor of the Commissioner.

1 276 Mass. 437

2 279 Mass. 168

(27) Ness vs. Commissioner of Corporations and Taxation[1]

This was a domicile case involving change of residence to Florida, Mr. Ness had formed the intention of taking up legal residence in Florida; but did not arrive in Florida until January of the following year. "Domicile of origin or domicile acquired remains until a new one is acquired" so that the court held that the new domicile did not become effective until actual arrival in the new place.

(28) Crocker vs. Commissioner of Corporations and Taxation[2]

In this case it was contended that in computing the cost of stock acquired partly by purchase and partly by stock dividends, that a value should be given to the shares acquired by stock dividends. The Commissioner maintained that the law was clear and that the actual cost should be divided over the number of shares acquired by stock dividends. The court found in favor of the Commissioner.

(29) Madden vs. Commissioner of Corporations and Taxation[3]

In this case Madden contended that in the acquisition of stock through the exercise of "rights" that to the actual cash subscription should be added the value of the "rights". The court held that by turning over the cash for the par value of the stock to the corporation accompanied by the surrender to the

1 279 Mass. 369
2 280 Mass. 238
3 280 Mass. 321

corporation of certain rights, is in substance and effect a purchase of the shares of stock from the corporation. Decision was made in favor of Madden.

(30) Tirrell vs. Commissioner of Corporations and Taxation[1]

This case decided that the income of property held in trust is not taxable as an annuity even the whole or any part of the payments to the beneficiaries is in the form of an annuity.

(31) Wellman vs. Commissioner of Corporations and Taxation[2]

This case involved the sale by the Vacuum Oil Company of all its assets to the Standard Oil Company of New York, payment being taken in shares of the latter company after an increase in the capital stock and a change in name to the Socony-Vacuum Corporation. It was held that the transaction constituted a dividend in liquidation to the stockholders of the Vacuum Oil Company and that the amount in value received by them over the value of their old stock was taxable as a dividend. Decision was for the Commissioner.

(32) Commissioner vs. Simmons[3]

This case involves the validity of a tax on income received by David A. Simmons upon his reaching the age of 21. The issue raised was whether accumulations of income received by

1 287 Mass. 464
2 289 Mass. 131
3 292 Mass. 507

the trustees and paid to Simmons were taxable. It was held that which the trustees transferred to Simmons was paid to him as a legacy and not income. The decision was found in favor of David A. Simmons.

(33) Commissioner of Corporations and Taxation vs. Hornblower[1]

This case decided that losses from bad margin accounts by stockbrokers are bad debts of principal and are not deductible from income.

(34) Boston Safe Deposit and Trust Company vs. Commissioner of Corporations and Taxation[2]

This case decided that dividends in liquidation paid to a stockholder in liquidation for cumulative preferred stock by a corporation which had no surplus and no accumulated income or profits were a distribution of capital even though such stockholder received an amount in excess of the original par value of his preferred stock.

(35) Brink vs. Commissioner of Corporations and Taxation[3]

This case decided that under the Constitution and the then existent Income Tax Law of Massachusetts, stock dividends could be taxed as income and that the Constitution of the United States in this respect did not impose a limitation upon the taxing powers of this Commonwealth.

1 296 Mass. 201
2 298 Mass. 263
3 299 Mass. 280

(36) The United States Trust Company vs. Commissioner of Corporations and Taxation[1]

This case decided that the retroactive part of St.1933 c307 sec. 9 was valid and did not violate the due process clause of the Fourteenth Amendment of the Constitution of the United States. The case further decided that there is no deduction from an income tax of the amount paid for a succession tax. A dividend in liquidation is taxable upon the excess over the corporation's shares and not upon the excess over the value pladed on such shares for inheritance tax purposes.

(37) Commissioner of Corporations and Taxation vs. Baker[2]

In this case it was decided that the remainder interest under the will of a resident testatrix were contingent and that the executors were properly taxed as being income accumulated in trust for unborn or unascertained persons or persons with uncertain interests[3] upon excess of gains over losses made by them from the purchases or sales of intangible personal property.

(38) Commissioner of Corporations and Taxation vs. Dalton[4]

In this case it was decided that payments made to a wife through a non-resident trustee under a separation agreement

1 299 Mass. 296
2 303 Mass. 600
3 General Law (Ter. Ed.) c62 sec. 9 and 10
4 304 Mass. 260

while not alimony were in the nature of alimony, and therefore were not taxable income received by the wife within the scope of the law.[1]

(39) Commissioner of Corporations and Taxation vs. Eaton[2]

In this case it was decided that the interest of an inhabitant of Massachusetts in the income received by a non-resident trustee, under the will of a non-resident testatrix was vested and that any income received by such inhabitant from such trustee was taxable, when received under the provisions of the law.[3]

1 General law (Ter. Ed.) c62 sec. 11

2 304 Mass. 147

3 General Law (Ter. Ed.) c62 sec. 11

Chapter 9 Report Of The Commissioner of Taxation (1916-1948)

It seemed that the best manner of finding out the results and operation of the income tax law of 1916 under the circumstances would be obtained by examining the reports which are made annually by the Commissioner of Taxation and Corporations to the legislature of the Commonwealth of Massachusetts.

1916

The income tax law was enacted during the latter part of May of this year. Sim e this law was not to go into operation until the following year (1917) most of the report for this year concerning the income tax law dealth with the preparations which were being made for administering the law efficiently when it would take effect.

The Tax Commissioner reported at the end of the fiscal year November 30, 1916, that the income tax division of the Tax Commissioner's department was in the process of formation. It was decided to be most feasible and desirable to divide the state into eight income tax districts and to place an income tax assessor with two or more deputies in charge of administering the income tax law in each district. The districts were comprised of the following territories:-

First District, Essex County. Second District, Middlesex County. Third District, Suffolk County. Fourth District, Norfolk and Plymouth Counties. Fifth District, Bristol, Barnstable, Dukes and Nantucket Counties. Sixth District, Worcester County. Seventh District, Franklin and Hampshire

Counties. Eighth District, Berkshire and Hampden Counties.

The income tax division of the Tax Commissioner's department undertook a vigorous campaign in the summer and fall of 1916 to promulgate the income tax law throughout the commonwealth with the intention and purpose of informing and educating the people of the state as thoroughly as possible as to just what was required of them in order to fulfill the requirements of the income tax law.

One method which was employed to accomplish this purpose was to furnish the various newspapers of the state with a weekly column and sometimes more frequently, which was concerned with setting forth a presentation in a popular fashion of some particular feature of the income tax law as well as and together with its chief requirements.

The department also compiled an extensive information file which was collected from all available sources in order to enable them to check up on the returns which were to be made in the following year as well as in future years and to guide it in requiring returns from those who have not yet learned of the requirements of the act. As was described previously this is a great advantage which is enjoyed due to the fact that the state, acting as a central collecting agency for the various towns and cities, finds itself in a much more opportune position to know or ascertain the reliability as well as the accuracy and correctness of the returns which are made.

"In the country at large and in Massachusetts also, some 75 per cent. of all taxes assessed

> upon property is assessed upon real estate. In Massachusetts this percentage will, in the future, be much larger owing to the fact that pursuant to the provisions of Chapter 269, of the general acts of 1916, intangible personal property becomes exempt and will no longer appear on the municipal valuation and tax lists."

The above statement will give some impression to the reader of the great amount of personal intangible property which has been able to escape and evade taxation with the existing methods prior to the enactment of the income tax law in 1916. This was pointed out and described in greater detail in an earlier section of this thesis so a more minute description will not be given at this time. However, it seemed that this fact was deserving and worthy of passing mention again.

1917

This was the first year that the law was in operation, although the act was passed by the legislature of the Commonwealth of Massachusetts the previous year it did not become effective until 1917. As a consequence a large part of the report of the Tax Commissioner for this year deals with the many complex problems of administration which would naturally arise at the commencement of attempts to administer a law of this nature.

Prior to the passage of the 1916 income tax law there had been no income tax law as such in the commonwealth, although many types of income were taxed under the general property tax and under various other special tax laws. This law concerning

the tax on incomes was applicable to only certain types of incomes. It is not what could be called a general income tax as the federal income tax is sometimes referred to as.

It is not something to be marveled at that the people of Massachusetts were quite commonly befuddled and confused concerning the manner in which the law was to operate and the precise relationship which was applicable to them as inhabitants of the Commonwealth of Massachusetts in regard to the income tax law of 1916.

The Tax Commissioner was aware of the situation in which the people found themselves. As a result even more intensive methods were adopted at the beginning of the fiscal year which was November 30, 1916. All the attempts to publicize the law were continued in the same manner as had been previously adopted and efforts were redoubled along new lines. The department continued to prepare and publish newspaper articles. Many of the taxpayers problems were solved by means of correspondence which the department carried on in order to answer the questions which were posed to them. Among the newer additional methods which the department adopted and maintained was the establishment of a Speaker's Bureau late in 1916 in order to properly advise all taxable persons of the requirements of the law. The Tax Commissioner's report states that several hundred addresses were delivered throughout the commonwealth either by members of the department or volunteers contributing their services. In addition to these efforts already mentioned a large

number of bulletins which interpreted the law in popular form were distributed widely, and many notices were furnished to banks and similar institutions in order that they might be distributed to their respective clients and members.

A majority of the returns were filed by mail. Towards the end when the deadline for the filing of returns was approaching much congestion resulted from the fact that a large number of individuals desired to obtain an interview in order that they might make inquiries concerning a part or parts of the act.

The report states that approximately 183,000 returns were filed on or before March 1. The results of a large number of these returns were quite disappointing and unsatisfactory due to the fact that so many were exceedingly incomplete and inaccurate in form. As a consequence in many instances it was found necessary to require the remailing of the forms back to the taxpayer for correction or completion. The report states,

> "a very large percentage of the persons filing showed much carelessness in the preparation of the returns, and in many cases there was a complete indifference to the requirements of the department. These defects resulted in a further burden on the department in its first year, which we believe will not arise as acutely hereafter."

As a result of the efforts of the tax department 9,000 returns of delinquents had already been filed and it was estimated from their records that at least 10,000 more would be received after they had completed their work.

The procedure which is employed by the department in their investigations is very interesting. These investigations are carried on in order to determine the verification of the returns which are filed. The department employs the four following methods in conducting their investigations: (1) correspondence (2) interviews with the taxpayer (3) formal examination under oath, (4) the auditing of books of accounts.

The report states,

> "The first two methods are employed in returns indicating inaccuracy or a misunderstanding of the law, while examination under oath are reserved for suspected cases of fraud."

It is very facinating to note the results of some of these investigations which have been produced according to the report of the Tax Commissioner. In some cases,

> "an auditor has produced in a single day's work an additional tax in excess of his own salary for the whole year. Special investigations---such as on the returns of fiduciaries, revealed omissions yielding additional taxes in excess of $25,000; as to the returns of stock dividends, yielding approximately $75,000; as to the returns of stock dividends on such stock as Amoskeag, Pepperell, the express company, Mackay, etc. yielding over $20,000---have amply justified the expense and labor entailed, as well as the slight in convenience placed upon these classes of taxpayers."

Many claims have been investigated which have involved the claims of non-residence. In many instances those persons who have been adjudged inhabitants of Massachusetts, have ac-

quiesced to the decision made by the department. Some of the cases which were still pending when this report was turned in may eventually yield an enormous amount of taxes. Here again the state department of taxation finds itself in a much better position to carry on this line of work than the individual localities could, with results which may turn out to be very promising.

Another salient feature which is connected to every tax is the cost of administration. Adam Smith proposed four maxims with regard to taxes in general. The fourth one that he proposed was that of economy in collection. He says,

> "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state. A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury, in the four following ways. First, the levying of it may require a great number of officers, whose salaries may eat up the greater part of the produce of the tax, and whose perquisites may impose another additional tax upon the people. Secondly, it may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintainance and employment to great multitudes. While it obliges the people to pay, it may thus diminish, or perhaps destroy, some of the funds which might enable them more easily to do so. Thirdly, by the forfeitures and other penalties which those unfortunate individuals incur who attempt unsuccessfully to evade the tax, it may frequently ruin them, and thereby put an end to the benefit which the community might have received from the employment of their capitals. ..... The law contrary to all the ordinary prin-

> ciples of justice, first creates the temptation, and then punishes those who yield to it; and it commonly enhances the punishment too in proportion to the very circumstance which ought certainly to alleviate it, the temptation to commit the crime. Fourthly, by subjecting the people to the frequent visits and the odious examination of the tax gatherers, it may expose them to unnecessary trouble, vexation, and oppression; and though vexation is not, strictly speaking, expense, it is certainly equivalent to the expense at which every man would be willing to redeem himself from it."[1]

The total expense the first year of collecting the income tax in Massachusetts was $226,356. This is equivalent to 1.86 per cent on the total assessment of $12,140,000.

Considering the cost of administering the tax for the first year, it would seem that this maxim of Adam Smith was adhered to in a very precise manner. It appears that a cost of less than two per cent is quite low for administering a tax of this nature for a whole year. It remains to be seen whether this record of the first can be maintained or even excelled. In viewing a tax of this sort there are many variables which have to be considered. It appears that the cost of administration is in an inverse ratio to the amount of taxes which are assessed. As the amount of the assessed taxes rise the cost of administration decrease, and conversely as the amount of the assessed taxes decrease, the cost of administration rises. This is due to the fact that the costs of administration are fixed

1 Smith, Adam, The Wealth of Nations Edited by Edwin Cannan (New York: Ramdom House, Inc., Publishers of the Modern Library 976 pp pp 778-779)

and are figured on a percentage basis.

1918 .

A greater part of the report of the Tax Commissioner for this year dealt with many of the same problems as for the preceding year. It appears only natural that the law being of such a complex kind cannot operate as smoothly as might be desired in its second year. It might be well to note that the difficulties and problems although of a similar nature were fewer in number.

A great many more of the returns which were filed in accordance with the law and the requirements of the department, had been treated with much greater concern.

As a result of the investigations which the department conducted during this year additional taxes amounting to $124,076 have been assessed.

The cost of administration was $208,027 which is equivalent to 1.44 per cent. on total assessment of $14,400,000. This represents a decrease of around $18,000 from the first year that the law was in operation.

The department estimates that the new income tax law yields an excess of $1,000,000 over the old law.

The department felt that the people, in general, were satisfied with the operation of the income tax law during its second year of operation. However, they recommended the discontinuance of certain minor features of the law which have resulted in quite a good deal of irritation without producing

sufficient revenue to justify continuance.

1919

On account of the increases in salaries and wages, there was a 12 per cent. increase in the number of returns filed over the best previous year. This increase in wages and salaries was due to the inflated wages of the war year. As a consequence of this increase in wages the income of a large number of individuals was raised into a higher bracket in which they were required to file a return.

This increase in the number of returns also had a tremendous effect on the cost of administration. More employees were hired as a result of the additional work load. Additional filing space was also necessitated because of this increase of returns. The cost of administration amounted to $313,679 which is equivalent to about 2 per cent. on the total assessment of $15,300,000.

In the case decided by the Supreme Court of Wilder v. Tax Commissioner the Court sustained the holding of the commissioner that when the International Paper Company offer of partly cash and partly stock of the company in settlement of an accumulated preferred dividends was accepted, it constituted a dividend which could be taxed under the act.

The tax yielded a return of $14,804,907 for this year. This was approximately a half million more than the previous year and also more than the first year that the law had been in operation. Thus more revenue is being derived from this

source each succeeding year.

1920

The number of returns for this year amounted to 240,000. This is an increase of around 20,000 over the previous year.

Some 6,500 additional returns on income, which had been delinquent, were secured almost entirely through the work and effort of the employees of the department.

The investigations produced an additional net gain over expenses of $56,481 in taxes.

The cost of administration for this year amounted to $307,879 which is equivalent to about 1.8 per cent. on a total assessment of $16,800,000. Thus the yield seems to be increasing each year.

1921

There were 286,000 returns filed-an increase of 46,000. Delinquent returns numbered 13,000 and the taxes assessed on these amounted to over $865,000. The investigations of the department produced additional taxes of $188,134. The cost of administration was less than 2 per cent. of the total assessment. The income tax yielded a revenue of $14,800,000.

1922

296,218 returns were filed-an increase of around 10,000. Delinquent returns numbered 18,499. The reason that this number is so large is that extroadinary effort was expended by the various sections of the income tax division. $160,789 was realized from these additional assessments. The investigations

resulted in an additional in taxes. The cost of administration was 2.33 per cent. of the total assessment. This was a slight increase over the preceding year. The yield of the income tax for this year was slightly over $13,000,000.

The remaining years of the annual reports of the Commissioner of Corporations and Taxation are very similar except for different figures for the various years and so it was deemed advisable for the sake of avoiding repetition to summarize these figures in tables. These tables may be found at the end of this chapter.

The following is a comparison of the early years with the last several years to show the contrast in the development of the administration of the income tax law. The yield from the tax increased from $12,562,194 to $37,137,808 from 1917 the first year that the act was in operation to the year 1948 the last year for which figure are available for a complete year. The number of returns also had a very large increase. In 1917, 183,000 returns were filed, and by 1948 this number had increased to 1,044,705. With this great increase in the yield and number of returns it was merely a natural consequence that the cost of administration would also increase. Thus, in 1918 the cost of administration was $208,027 and in 1948 it had increased to $1,036,242. This was due not only to the great increase in the amount of yield and in the number of returns, but also to the sharp rise in costs with which the department was confronted especially the increase in salaries, which is a

major item in any department of the government.

By 1948 there had been quite a change in the kind of returns which had to be filed. It is only natural that the forms which would facilitate the greatest ease in handling could not be worked out the first year. The necessity of being able to handle these returns quickly and efficiently can not be overstressed. If the forms are not checked by a certain date and a refund has to be made, the state must pay interest on the amount of money which has to be refunded after that date. There are now seven different forms on which income returns are filed. They are:

a) individual form 1

b) fiduciaries form 2 and 2B

c) partnerships form 3

d) associations etc. having transferable shares form 3F

e) dealers in intangibles form 3C

f) clubs etc. not in business for profit 3M

The Massachusetts income tax is distributed to the various towns, cities and districts after the amount of the administration is deducted, and since 1933 a sum retained as provided by Chapter 357 of the acts of 1933. The distribution for the years 1919-1923 are summarized in table 4 at the end of this chapter. In 1946 according to figures in Financing State Government in Massachusetts,[1] "out of a yield of

[1] Massachusetts Federation of Taxpayers Association, Inc., Financing State Government in Massachusetts (Boston: Massachusetts Federation of Taxpayers Association Inc. 1947 29 pp p 17)

$31,869,246, $22,300,276 was distributed to cities and towns as follows:

4,796,776	was distributed on the basis of number of teachers etc.
17,501,500	was distributed on the State Tax Basis
2,000	a special payment made to the town of Savoy"

Table 1 Revenue From Income Tax In Massachusetts 1917-1948

1917	$12,562,194
1918	15,026,682
1919	15,692,304
1920	16,861,696
1921	14,741,107
1922	13,004,979
1923	14,281,959
1924	17,143,806
1925	17,682,492
1926	21,871,776
1927	21,465,251
1928	24,220,800
1929	28,957,593
1930	32,206,083
1931	23,627,395
1932	18,909,855
1933	13,971,959
1934	14,940,014
1935	16,829,826
1936	17,758,147
1937	24,677,008
1938	23,947,430
1939	18,398,661
1940	20,292,146
1941	21,182,180
1942	24,323,794
1943	17,597,387
1944	25,144,502
1945	23,136,960
1946	30,368,924
1947	35,128,889
1948	37,137,808

Table 2 Number of Returns filed 1940-1948

1940	454,269
1941	492,896
1942	*
1943	*
1944	*
1945	453,147
1946	*
1947	904,557
1948	1,044,705

* Data not available

Table 3 Cost of Administration 1923-1948

Year	Cost	Percentage of Total Assessment
1923	$328,000	2.33
1924	461,048	2.6
1925	472,006	2.6
1926	479,304	2.2
1927	485,659	2.25
1928	514,284	2.1
1929	539,272	1.8
1930	563,877	1.7
1931	580,527	2.4
1932	573,079	3.0
1933	556,328	3.98
1934	599,194	3.59
1935	637,573	3.78
1936	675,060	3.65
1937	677,428	2.74
1938	738,328	3.08
1939	735,408	3.6
1940	672,245	3.3
1941	727,133	3.4
1942	727,494	2.9
1943	402,156	
1944	775,851	3.0
1945	820,420	3.5
1946	890,007	2.9
1947	802,578	2.2
1948	1,036,242	2.9

Table 4 Distribution of Income Taxes For 1919-1923*

The following table shows the amount and the manner of the distributions of the income tax collections for the years 1919-1923:

	1919	1920	1921	1922	1923
For distribution	15,409	17,217	14,669	12,842	14,182
Distributions To Municipalities					
Reimbursement	7,077	6,290	5,503	4,718	3,931
State tax	4,375	6,295	4,190	2,990	5,850
Educational Encouragement	3,145	3,850	4,165	4,415	4,521
Distribution To Districts	15	18	16	14	11
Emergency Tax Chapter 342, 1919	798	749	782	700	---

This distribution is made to the municipalities and districts after deducting the expenses of administration.

* Source various annual reports of the Commissioner of Taxation

Chapter 10 Comparison of the Problem of Income Taxation In Massachusetts To Those in the Other States

At the present time most of the states have some form of an income tax. Some tax only the income of individuals, while others restrict their tax to corporations, and some tax both of these.[1] Edward Allen, in writing on this subject says,

> "While 33 states (including the District of Columbia) made use of personal income taxation in 1946 tax revenues from this particular source were less than 7 per cent of total state tax revenues."

This does not appear to be the case here in Massachusetts as is found as an average for the country as a whole. The Special committee on Taxation which the 1948 legislature set up found that,[2]

> "Income taxes, for example, represent the principal source of governmental revenue in Massachusetts today, but over 95 per cent of income tax collections are made by the federal government, of a total of $782.1 million paid as individual income taxes in Massachusetts in 1947 some $747,000,000, or 95.5 per cent, went to federal tax coffers."

so it is apparent that Massachusetts is quite a little below the average for the country as a whole.

1 Allen, Edward D., and Brownlee, O.H., Economics of Public Finance, (New York: Prentice-Hall, Inc., 1947, 535 pp p 270)

2 Commonwealth of Massachusetts, Preliminary Report of the Special Commission on Taxation of 1948A Tax Inquiry For Massachusetts (Boston: Wright and Potter Printing Co., Legislative Printers 1949 58 pp p 32)

In Massachusetts intangibles are taxed by a flat rate. This is not the case in states where a progressive income tax is in force. Most of the states follow the federal government and have a progressive income tax. There are many arguments both pro and con as to whether or not it is more favorable to have this form of taxation. In the following paragraphs an effort will be made to summarize the most important of these arguments.

It might be well to mention at this point that at the time this thesis is being written the state legislature is considering an amendment to the constitution of the Commonwealth of Massachusetts to be later ratified by the people of the commonwealth if it is adopted, to have the constitution changed so that progressive rates may be used in computing the income tax. Laws concerning income tax are changed so rapidly and frequently, that most anything written concerning the subject, is antiquated almost before it is finished.

Those who favor a flat rate tax on incomes argue that more revenue is obtained by this method than any other. The special Commission on Taxation and Expenditures in 1938 found[1] that,

> "In the country as a whole, the method of taxing intangibles by a special flat rate tax on incomes has proved more productive of revenue than either a classified property tax, or a general income tax at progressively higher rates."

[1] Commonwealth of Massachusetts, Report of the Special Commission on Taxation and Expenditures Part III The Tax Structure (Boston: Wright and Potter Printing Co., Legislative Printers 1938 p 104)

Another argument used in connection with a low rate on intangibles is that when there is a low rate on this type of income people are much more willing to admit that they possess such revenue and as a result a great deal more intangible property is taxed and a much higher yield is realized because of this. In this manner the tax burden is able to be spread over a great many more persons and thus the tax load seems much lighter for a good many people as it really is. Harold Groves is very optimistic over the low rate taxation on intangibles and says,[1]

> "Low rate taxation of intangibles, now in vogue in a number of states, probably has improved the level of property tax administration to some extent but not enough."

Those who argue in favor of a progressive income tax claim that it reduces the regressiveness of local taxation. The poll tax, the general property tax and the other property taxes are very regressive in their very nature, and also that it is more equitable as the ability that an individual has to pay taxes does not increase at the same rate as his revenue increases. On this matter Harold Groves says,[2]

> "Most important perhaps, is the fact that the income tax provides the one important available progressive tax by means of which the people of any state can eliminate or reduce the regressivity of their state and local tax systems."

1 Groves, Harold M., Postwar Taxation and Economic Progress (New York: McGraw Hill Book Company, Inc., 1946 430 pp p 340)

2 Groves, Harold M., Viewpoints on Public Finance, (New York: Henry Holt and Company, 1947 764 pp p 217)

Chapter II Conclusions

It is difficult to make a comparison of the yield when each town collected the income tax under the property tax and the yield after the income tax law became effective and this function was adopted by the state,as changes occurred.This comparison would not be conclusive by any means as the tax would have to be judged on many more merits than merely its yield,nevertheless,some light should be thrown on the subject by this comparison.An exact comparison of the results of the act as a tax on incomes from intangibles with the yield of the old law would be impossible.

The old tax on capital value was yielding around $8.5 million,and the income tax law produces from this class of property $8,397,503.In this figure is included the loss from $300 exemption of interest and dividends,which had no place in the old law.Thus an allowance should be made for this loss in a consideration of the two figures.Similarly it is estimated that much revenue is waived by the exemption of non-resident beneficiaries of estates and trusts who were taxable under the old law.If these two items,representing a total of $2,133,333 were subtracted from the estimated yield of $8,500,000 it would leave $6,367,000 for comparison with $8,397,000 raised by the the tax on income from intangibles under the new income tax law.

The wealthier class,in most cases are paying more than in the past,many who paid nothing under the old tax law were

forced to pay and share some of the tax burden;while many of small means,through the exemptions provided by the act,are now given proper relief.

Many small businesses have benefited from the better bookkeeping methods,which had to be introduced with the commencement of the operation of the law.For it is a commonly admitted fact that the cause of many business failures,especially among the smaller firms,is due to the lack of proper bookkeeping.

The tax commissioner[1] feels that "an equitable tax that all can afford has been substituted for one that was driving wealth from the state."

All of the states are required by the Constitution of the United States to treat non-residents in the same manner as the inhabitants of that particular state in question are used.However,some states have been able to escape this in actual practice through the device generally referred to as 'red tape'.Blakey and Johnson[2] mention this when they say,

> "Many states provide for the withholding tax from income paid non-residents calculated at the highest rate of tax ,remitting the excess to the taxpayer if he files a return and shows a smaller amount due.

There have been many proposals made for changes in

[1] Report of the Commissioner of Taxation 1917,p 19

[2] Blakey Roy G.,and Johnson,Violet,State Income Taxes (New York: Commerce Clearing House Inc. 1942 132 pp p 152)

the laws which are in vogue in the various states .An earnest endeavor will be made at this point to describe the most important of these in order to indicate what may be expected in the future in regard to any changes in the income tax laws for the several states.

The Twentieth Century Fund,which is an organization located in New York,has made a study of the tax problem and has proposed,[1]

> "That the constitution of the federal government and the state governments be amended to give legislators greater freedom in defining taxable income, particularly to enable them to tax gains before they are realized and to tax corporate earnings.

Many writers on the subject believe that there should be closer cooperation between the state and the federal governments in regard to income taxation.P.L.Ecker says,[2]

> "The taxation of incomes by the federal government and the states independently of one another and without regard for the actions and plans of the other, precludes the distribution of the tax burden in conformity with any pattern."

Even the federal government agrees that the necessity of cooperation between the state and the federal government in this respect is deserving of a good deal of consideration.The United States Treasury department says,

1 Twentieth Century Fund,Inc.,Facing the Tax Problem,(New York: Twentieth Century Fund,Inc.,1937 [illegible] pp p 20)

2 Ecker,P.L.,Proceedings of the Thirty Fourth Annual Conference OnTaxation ,(Washington,D.C. 1941 812 pp p54)

> "Coordination in Federal and State income taxation is of first rate importance, for it is in this field that multiple taxation threatened (and perhaps actual) interstate migration, and high compliance costs are particularly prominent." 1

In concluding this thesis I do not wish to claim that Massachusetts has the best income tax law of any of the states, for it is quite true that there is a wide divergence among the various states as to what is good or bad. What might be very appropriate for this state might be detrimental for another one. In a changing economy such as the one in which we live, it will always be necessary to keep changing our tax laws. However, I believe that we can say with quite a bit of confidence, judging from what is occuring in the United States at the present time, that the income tax not only for the several states but also for the federal government as well, is becoming more and more important every year. The various governments not only in this country, but also in many of the other countries, are becoming more and more dependent upon the income tax as their main source of revenue.

Whether the time will come when the income tax will be the only tax is difficult to say, and remains to be seen. It would indeed be unfortunate, if the other taxes were eliminated

1 United States Government, Federal, State, and Local Government Fiscal Relations, (Washington, D.C. United States Government Printing Office 1143 505 pp p 12)

altogether,nevertheless, we can say with quite a bit of assurance from the environment in which we live,that the other taxes are being relegated to a very insignificant position as time passes.

It might be well to mention in passing that the State of New Jersey adopted the Massachusetts formula for the income tax act,which was passed by that state in 1935. This does not prove by any means that the Massachusetts tax is superior to that of all the other states or even most of them,but it does indicate that it is an excellent tax law of its type.

Massachusetts has had an income tax of some sort continously since the colonial days and because of this great amount of experience,is in a favorable position to give a great deal of assistance to some of the other states,which have not had as much experience.

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Abstract

The history of the Massachusetts income tax dates back to the early laws of the Massachusetts Bay Colony. Massachusetts is the only state that has had some kind of partial income tax in effect continously since the early colonial period. Some authors have found that the income tax antecedes the Christian era and there might have been one in Egypt as early as 3000 B.C. . In the United States a federal income tax was imposed in 1862 and again in 1894, but the present tax did not become effective until 1913.

Many of the smaller towns levied a very low tax rate on intangible personal property. In the larger cities the tax rate on this kind of property was rather high in comparison to that which existed in the smaller towns. As a consequence, it was a common practice for wealthy individuals to establish residence in these smaller places in order to escape the high taxation of the cities. The day before the tax was due they would participate in a great exodus from the city to the place of their summer dwelling, and return the following night. The purpose of the Massachusetts income tax was primarily to eliminate this evil practice and not that of raising revenue.

The state is in much better position to collect the tax on intangible personal property for the various towns and cities. Their facilities are larger to a great, and in many instances the methods that they employ are much more refined in accomplishing this undertaking.

There were several early attempts at reform in regard to the property tax in Massachusetts.In 1869 a law was enacted,which made it mandatory for the savings banks to pay a tax on their deposits.In 1884 a similar law was passed,which introduced a tax on the capital stock in Massachusetts corporations.These two laws exempted taxpayers from their former obligation.In 1881 a special law was passed governing the tax on mortgages on taxable Massachusetts realty.

Personal earnings over $2,000 (faculty-income)and stocks,bonds and notes were taxed under the general property tax prior to 1916 when the income tax law was passed.

Before an income tax law could be passed for the Commonwealth of Massachusetts it was necessary to make an amendment to the constitution .On May 16,1 the State Legislatureadopted an amendment to the State Constitution,striking out the word proportional in relation to taxation.In November of 1915 the people approved and ratified the forty-fourth amendment to the constitution of this commonwealth.

The Massachusetts income tax is usually referred to as a partial or classified income tax.The following types of income are taxed:(1)interest from bonds,notes,money at interest,and from all debts due the person to be taxed,were taxed at the rate of 6 per cent ; (2)personal earnings over $2,000 were to be taxed at the rate of 1 per cent.(3)profits from the sale of intangibles were to be taxed at the rate of 5 per cent.

The following deductions are permitted:Debts,except those which are secured by mortgage or pledge of real estate or tangible personal property;debts owed by other persons.

In regard to the making of returns,every individual of the commonwealth,including every partnership,association or trust,whose annual income from all sources exceeds two thousand of dollars must make out a return of his entire income annually.

The tax commissioner is obliged to determine the income of every individual who is to be taxed under the act and assess the amount of the tax provided by this income tax of 1916. Any person,who is aggrieved by the assessment of a tax under the provisions of this act may apply to the tax commissioner for an abatement.

If a person fails to file a return within the time prescribed,the sum of five dollars for every day during which this person is in default is added to and becomes part of the tax.

The most important change in the act has been the imposition of a 50% tax upon gains realized from the taking of property by eminent domain within a year after the property has been acquired by the taxpayer.

For the purposes of administration the state was divided into eight districts with an income tax assessor and and two or more deputies in charge of administering the income tax law in each districts.

The number of returns filed has increased from 185,000 in 1917 to over a million in 1948.During these same years the amount of revenue increased from 12 to 37 million dollars.The cost of administration also increased during these years. The cost of administration in 1917 was $226,356.This is equivalent to 1.86 per cent on the total assessment of $12,180,000. In 1948 the cost of administration was slightly over one million dollars.This was equivalent to 2.9 per cent of the total assessment .The percentage of cost to total assessment varies with the amount of the assessment,which in turn varies with business conditions and employment.In 1932,for example, the percentage of cost to total assessment increased to 7.98 per cent due to the low yield on account of the depression,which swept the country at that time.

The department of taxation maintains an investigation section in order to verify the returns made by individuals.A great amount of revenue is obtained through these investigations ,which otherwise would be lost to the commonwealth.These investigations pay for themselves many times over and above their cost.

In 1946 33 other states (including the District of Columbia)made use of personal income taxation.Some tax only the of individuals,while others restrict their tax to corporations, and some tax both of these.In 1946 tax revenues from personal income taxation in American states amounted to less than 7 per cent of total state tax revenues.

It is difficult to make a comparison of the amount of revenue obtained under the income tax act of 1915 with that obtained under the old law. Nevertheless, it is estimated that the difference is approximately a little less than 2 million dollars more under the new law of 1915.

The wealthier class, in most cases are paying more than in the past, many who paid nothing under the old tax law were forced to pay and share some of the tax burden; while many of small means, through the exemptions provided by the act, are now given the proper relief.

Many small businesses have benefitted from the better bookkeeping methods, which had to be introduced with the commencement of the operation of the law. Many small firms fail due to improper bookkeeping.

The tax commissioner feels that an equitable tax that all can afford has been substituted for one that was driving wealth from the state .

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